78-1690

IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. .....

UNION BANK,

Petitioner,

v.

JAMES BLOOR, as Trustee in Reorganization of IFC Collateral Corporation and IFC Serramonte Estates Corporation, Debtors, and DAMAVANDI ENTERPRISES, INC.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

HOWARD I. FRIEDMAN, Esq.
One Wilshire Boulevard
Los Angeles, California 90017
(213) 629-0200

LOEB & LOEB
of Los Angeles, California
Of Counsel

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Petitioner Union Bank (the "Bank") prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit (the "Court of Appeals") entered in the above case on February 8, 1979.

Opinion Below

The United States District Court for the Southern District of New York (the "District Court") rendered no

opinion. The opinion of the Court of Appeals is reported at 592 F.2d 134 (A-1).*

Jurisdiction

The judgment of the Court of Appeals was made and entered on February 8, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Was it proper for the Court of Appeals to entirely disregard a stipulation between the parties on the pivotal factual issue in the case and instead unilaterally substitute its own view.

2. In a Chapter X reorganization proceeding can a mortgagee, already prevented for over three years from foreclosing on its collateral, be further stayed on account of the District Court's approval of a contract of sale of the liened property, which contract is nothing more than a one year option to purchase at minimal cost to the buyer and dependent on the obtaining of zoning changes.

Statement of the Case

This litigation is a part of reorganization proceedings commenced on October 21, 1974 under Chapter X of the Bankruptcy Act (11 USC §§ 501-676) by Investors Funding Corporation of New York ("IFCNY") and certain of its subsidiaries in the District Court. On November 1, 1974, James Bloor was appointed Chapter X Trustee (the "Trustee") of all debtors.

* References preceded by "A" are to the Appendix to this petition. References preceded by "JA" are to the joint appendix in the Court of Appeals. References preceded by "Tr" are to the Transcript of Trial before Bankruptcy Judge Galgay held on November 10, 1977.

On September 10, 1975, the Bank commenced proceedings before the District Court (the "adversary proceeding") seeking a vacation of all stays so as to permit the Bank to foreclose its first mortgage lien on a certain parcel of undeveloped real property located in Daly County, San Mateo, California (the "Property") (JA11-52). IFC Collateral Corporation ("Collateral") and IFC Serramonte Estates Corporation ("Serramonte"), (collectively the "Debtors") subsidiaries of IFCNY and in Chapter X proceedings, are, respectively, the holder of a second mortgage and the fee owner of the Property.

On October 21, 1975, the District Court referred the issues presented by the adversary proceeding to Bankruptcy Judge John J. Galgay, as special master to hear and report (JA53-54) and on November 10, 1977 a trial was held before the bankruptcy judge. Evidence was adduced during the trial with respect to the issues raised by the pleadings, including (i) whether the Debtors had any equity in the Property, (ii) the validity of the affirmative defenses and counterclaims asserted by the Trustee in a proposed amended answer with respect to the enforcement of a certain subordination agreement executed by Debtors for the benefit of the Bank, and (iii) the terms and conditions and effect on the parties of a proposed contract of sale by the Trustee of the Property (the "Contract") (JA184, 198).

On November 2, 1977, the Trustee obtained an order to show cause from the District Court setting December 7, 1977 as the date for a hearing to consider the Trustee's application for authorization to sell the Property free and clear of liens, with liens to attach to the proceeds of sale pursuant to the Contract (JA110-15).

While the Contract provides for a purchase price of $1,440,000 (JA133, 307-08), the purchaser need only deposit in escrow $70,000 (JA133, 298-99). The balance of the purchase price, or $1,370,000, is not due unless and

until certain conditions have occurred including purchaser's obtaining final approval from the Daly City Council of a subdivision development plan and rezoning permitting at least 186 residential units (JA145-49).

In the event that all requisite conditions are not met, purchaser is entitled to the return of all but $10,000 of the deposit and has no further liability with respect to the Contract (JA148-49, 222-23). Furthermore, even assuming that the necessary planning board approval has been obtained, if purchaser chooses not to complete the Contract, then its liability is limited to forfeiture of the deposit (JA150, 223).

Under the terms of the Contract, purchaser is granted at least a full year in which to obtain planning board approval and at the option of the parties to the Contract, that period may be further indefinitely extended through inaction (JA147-49, 197, 225-27).

At hearings before the District Court on November 30, 1971 and December 7, 1977, and in papers submitted to that Court, the Bank argued, *inter alia,* that the Contract was nothing more than a one year option and that the Bank should be permitted to foreclose its lien.

It was established that (i) the Bank and the Trustee had stipulated that the fair market value of the Property was $1 million (JA90-91); (ii) the Bank's mortgage lien was almost $800,000 including principal, interest, attorneys' fees and outstanding real property taxes (A7; JA195, 212, 277) and (iii) mechanics' liens had been filed on the Property in the aggregate principal amount of $494,630.83 (JA121; Tr 46-47) together with interest accrued through November 10, 1977 in the amount of $125,452 (*Ibid.*), which lienors contended that their liens were superior to that of all other claimants to the Property (JA122, 183). No finding was made by the District Court with regard to the validity of the mechanics lienor's claims. Nevertheless the District Court concluded that the Trustee had demonstrated that Debtors had an equity in the Property (JA281-82).

At the December 7, 1977 hearing, Damavandi Enterprises, Inc. made the highest bid on the same terms as set forth in the Contract in the amount of $1,440,000 and on January 26, 1978, the District Court signed an order approving the Contract.

The Bank appealed to the Court of Appeals. In its decision affirming the District Court's order, the Court of Appeals criticized the absence of detailed written findings of fact by the District Court (A3-4). In view of the lack of findings, the appellate court searched the record in an effort to determine whether there was support for, *inter alia,* the critical factual issue of whether Debtors had equity in the Property.

In determining that question the Court of Appeals discarded a stipulation by the parties that the fair market value of the Property was only $1,000,000, found that such stipulation did not take account of the likelihood of subdivision approval with respect to the Property and valued the Property in an indeterminate amount close to $1,440,000 (A6-7). Based on the Property having such a value, the Court of Appeals concluded that a finding that the estate has an equity in the Property was not clearly erroneous (A8). The Court's analysis as to the value of the Property, and the resulting "substantial equity" of Debtors (A7-8) was also cited as a factor distinguishing *Lincoln-Alliance Bank & Trust Co.* v. *Dye,* 115 F.2d 234 (2d Cir. 1940), where it was held that a trustee in a Chapter X reorganization proceeding was not entitled to a continuation of a stay preventing a mortgagee from foreclosing when the mortgagee had already been stayed for fourteen months.

Reasons for Granting the Writ

I. The Decision Below Raises Significant and Recurring Problems Concerning the Conduct of Trials and the Scope of Appellate Review

The case at bar raises fundamental questions concerning the conduct of trials and appeals. One of the key issues in every adversary proceeding commenced in a bankruptcy court which seeks the vacation of stays preventing a secured party from foreclosing on its collateral is whether the bankrupt or debtor has equity in the liened property. The parties herein resolved this issue as a result of negotiations before trial and entered into a stipulation which fixed the fair market value of the Property at one million dollars (JA90-91).

Notwithstanding this stipulation, and obviously because the District Court failed to make the findings of fact and conclusions of law required by Rule 52(a) of the Federal Rules of Civil Procedure, made applicable to these reorganization proceedings by Rule 752 of the Bankruptcy Rules of Procedure and Chapter X Rule 10-701, the Court of Appeals improperly rejected the stipulation. Instead, the Court of Appeals substituted its own view as to the value of the Property and concluded that the value was not $1,000,000 but closer to $1,440,000 (A6-7). This caused the Court of Appeals to erroneously conclude that despite the existence of the Bank's first mortgage lien in the amount of almost $800,000 and mechanics' lien claimants, who asserted a first lien priority, in excess of $600,000, the District Court did not err in concluding that Debtors' had an equity in the Property.

By, in effect, trying the case *de novo* as to this issue the Court of Appeals considered an issue which was not properly before it. Since the parties had stipulated the value of the Property, the Court of Appeals was not free to disregard the terms of that stipulation. The ability of litigants to limit factual issues contributes to efficient judicial administration. Moreover, having entered into such a stipulation, fundamental fairness to the parties requires that it be given effect in the absence of some countervailing policy consideration.

In *Tucker* v. *Alexander,* 275 U.S. 228 (1927), this Court reversed a judgment entered by the Court of Appeals for the Eighth Circuit because the lower court ignored a stipulation between the parties and decided an issue which had been taken out of the case by the stipulation. And in *Danforth* v. *United States,* 308 U.S. 271 (1939), this Court held that where the government had stipulated with the owner of land as to the value of an easement it sought to take by condemnation, it was reversible error for the trial court to award the owner less than the agreed price. Mr. Justice Reed succinctly stated the reasons why it is essential for courts to honor such agreements:

> "The effect of such an agreement is to fix the value of the easement when the authority of the Court is invoked against a party to the agreement. . . . The convenience of a preparation for trial and the interest of orderly procedure was decisive there [in *Tucker* v. *Alexander, supra*]. Here the same reasons . . . leads to the conclusion that the trial court erred in striking the answer and refusing the motion to determine the value at the agreed price." 308 U.S. at 282-83

In making findings of fact where none existed and in disregarding the parties' stipulation as to value the Court of Appeals entirely misconceived its proper role. This Court should grant certiorari in the exercise of its supervisory powers over the lower federal courts in order to establish the proper limits of appellate review.

II. The Decision Below Decides An Important Question of Law Relating to the Administration of Bankruptcy Estates

The question of the duration of a stay of secured creditors occasioned by the filing of a petition under one of the Chapters of the Bankruptcy Act is a recurring and serious problem. In the case at bar, the Bank has been stayed from exercising its right of foreclosure for well over four years. Even assuming *arguendo* that Debtors' have or had an equity in the Property,* it is the Bank's position that a secured creditor can not, as here, be indefinitely prevented from realizing by foreclosure on the collateral.

Interesting enough, the leading case standing for the position advanced by the Bank is a decision by the Court of Appeals in *Lincoln-Alliance Bank & Trust Co.* v. *Dye,* 115 F.2d 234 (2d Cir. 1940). The Court of Appeals in the instant case seeks to distinguish *Lincoln-Alliance* on various grounds. For example, the Court of Appeals suggests that there is a "possibility of a viable reorganization plan" herein (A8). The Court of Appeals' analysis is fallacious. There was no evidence of a viable plan of reorganization before the District Court when it approved the Contract. Indeed the Trustee had concluded in his report made pursuant to Section 167 of the Bankruptcy Act that the estates must be liquidated (JA62-63). The only suggestion of a plan of reorganization involving a surviving entity was improperly interjected by the Trustee through a newspaper article made after the District Court's order was entered and attached to the Trustee's brief to the Court of Appeals. Furthermore, even if such a plan of reorganization is eventually proposed, it is obvious that the Property is not necessary to the consummation of such plan since

* Each year, additional interest accrues on the Bank's first mortgage in the amount of almost $70,000 (JA275; Tr. 28) and taxes accrue on the Property in an amount of approximately $20,000 (A127).

the Trustee has sought by the Contract to sell the Property.* Nor are the other distinctions cited by the Court of Appeals persuasive (A8).

The basic point is that the issue of whether, even assuming the Debtors have equity in the liened property, a mortgagee can be indefinitely barred from exercising its rights as a secured party in a bankruptcy proceeding has not been determined by this Court. This issue is an important one involving a balancing of competing interests between secured creditors on the one hand and other creditors of estates in bankruptcy proceedings on the other hand.

CONCLUSION

For these reasons, a writ of certiorari should be issued to review the judgment of the Second Circuit.

Respectfully submitted,

HOWARD I. FRIEDMAN, Esq.
Counsel for Petitioner Union Bank
One Wilshire Boulevard
Los Angeles, California 90017
(213) 629-0200

LOEB & LOEB
of Los Angeles, California
Of Counsel

May 8, 1979

* To date, no plan of reorganization has been submitted to the District Court. Nor has there been any showing that the proceeds of the sale of the Property are necessary to the realization of any plan to be proposed.

APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 90—August Term, 1978.

(Argued November 13, 1978 Decided February 8, 1979.)

Docket No. 78-5012

In the Matter of INVESTORS FUNDING CORPORATION OF NEW YORK, *et al.*,

Debtors.

UNION BANK,

Appellant,

—v.—

JAMES BLOOR, as Trustee in Reorganization of IFC COLLATERAL CORPORATION and IFC SERRAMONTE ESTATES CORPORATION, *Debtors*, and DAMAVANDI ENTERPRISES, INC.,

Appellees.

Before:

OAKES and VAN GRAAFEILAND, *Circuit Judges*, and MISHLER, *District Judge.**

Appeal by mortgagee from order approving trustee's sale of real estate in Chapter X proceeding of United States District Court for the Southern District of New York, Dudley

* Of the Eastern District of New York, sitting by designation.

B. Bonsal, *Judge*. Order held not to be abuse of discretion where debtor had equity even though sale is contingent on municipal approval of rezoning where buyer has made substantial financial commitments and has obligated itself to prepare and submit the necessary rezoning application.

RICHARD S. TODER, New York, N.Y. (Richard A. Gerard, Zalkin, Rodin & Goodman, New York, N.Y., of counsel), *for Appellant Union Bank.*

ALAN B. MILLER, New York, N.Y. (Lawrence Mittman, Weil, Gotshall & Manges, New York, N.Y., of counsel), *for Appellant Reorganization Trustee.*

FRED K. HOWELL, JR., Berkeley, Cal., *for Appellant Damavandi.*

PER CURIAM:

This case arises from a Chapter X reorganization proceeding in the United States District Court for the Southern District of New York, Dudley B. Bonsal, *Judge*. It involves Investors Funding Corporation of New York ("IFC") and thirty-three other debtor corporations, including IFC Collateral Corporation ("Collateral") and IFC Serramonte Estates Corporation ("Serramonte"). Union Bank appeals from an order of Judge Bonsal which authorizes appellee James Bloor, the Reorganization Trustee of all the debtors including Serramonte, to perform a contract of sale for a parcel of Serramonte's real property free of encumbrances (including Union Bank's mortgage lien and an $880,000 deed of trust held by Collateral), such encumbrances to attach to the pro-

ceeds of the sale. The other party to the contract is appellee Damavandi Enterprises, Inc. The bank argues that the order deprived the bank of its right, in the absence of a reorganization plan, to foreclose on its collateral within a reasonable period of time.

The bank contends that the contract authorized by the order is not a sale of the property, which is located adjacent to a freeway on the San Francisco Bay Peninsula, but in reality a one-year option to purchase it, since the purchase authorization is contingent upon approval of a subdivision or rezoning plan by the Daly City, California, city council. Because three years had already elapsed between the filing of Chapter X proceedings and the issuance of the sale authorization order, and because there is no assurance that the sale will be consummated, the bank argues that it should be allowed to foreclose without any further delay.

The court in a Chapter X proceeding may approve the sale of property in its discretion, 11 U.S.C. § 516 (3); *see Frank* v. *Drine-O-Matic*, 136 F.2d 906 (2d Cir. 1943) (per curiam). Generally, a sale free of encumbrances is disfavored if the aggregate of the encumbrances is greater than the proceeds of the sale but favored if the estate has an equity in the property and the sale is in the best interests of the estate. *In re Miller*, 95 F.2d 441, 442-43 (7th Cir. 1938); 4B *Collier on Bankruptcy* ¶ 70.97, at 1139-41 (14th ed. 1978). Although no findings appear in the order, it is evident from comments by Judge Bonsal recorded in the transcript of the hearing on the merits of the sale[1] that Judge Bonsal found that the estate did have an equity in the property and that the sale was in the best interests of all concerned. The bank challenges both findings.

We note at this point that detailed, written findings of fact supporting the court's use of discretion in allowing a

1 Transcript of hearing before Judge Bonsal held on January 4, 1978, Appendix on Appeal 267, *In re Investors Funding Corp. of New York*, No. 74-B-1454 (S.D.N.Y., filed Oct. 21, 1974).

sale of property of the debtor greatly facilitate appellate review. We urge district judges, and the bankruptcy judges who will be adjudicating such issues under the new Bankruptcy Reform Act, to make such findings. In this case, in the absence of such findings, we must search the record to see if there exists sufficient evidence to support the general factual conclusions that the district court must have reached in order not to have abused its discretion in approving the sale contract.

A preliminary question is whether, for the purpose of evaluating the estate's equity, the land should be valued only at its fair market value without subdivision plan approval, stipulated by the parties as $1,000,000 as of July 5, 1977, or at its expected sale price of $1,440,000, or at an intermediate figure. We do not accept the proposition that the land must be valued at the lower amount. Although there is a paucity of case law dealing with valuation of land in bankruptcy proceedings, we find support for our conclusion in related areas of the law.

We first look for guidance in the field of valuation in condemnation proceedings. In this circuit, the applicable law was stated in *United States* v. *Meadow Brook Club,* 259 F.2d 41, 44-45 (2d Cir.), *cert. denied,* 358 U.S. 921 (1958):

> Just compensation compatible with the requirements of the Fifth Amendment is the fair market value of the condemned property just prior to the taking. . . . This evaluation should reflect not only the purpose for which the property has theretofore been used, but other uses which might render it more profitable. . . . It would be improper to value the property as if it were actually being used for the more valuable purpose. . . . Obviously the more profitable operation must be one allowed by law to be carried out on the premises. Thus if existing zoning restrictions preclude a more profitable use, ordinarily such use should not be considered in the evaluation.

> . . . *On the other hand if there is a reasonable possibility that the zoning classification will be changed, this possibility should be considered in arriving at the proper value.*

(Emphasis added; citations omitted.)

Several other circuits have expressly endorsed this reasoning. For example, in *Wolf* v. *Puerto Rico,* 341 F.2d 945 (1st Cir. 1965), the court stated:

> The highest and best possible use of property is not confined to the use at the time of taking. Neither is it confined by the zoning at the time of the taking, if there is a reasonable possibility that there may be a re-zoning. . . . "When 'there is a possibility or probability that the zoning restriction may in the near future be repealed or amended so as to permit the use in question, *such likelihood may be considered* if the prospect of such repeal or amendment is sufficiently likely as to have an appreciable influence upon present market value. It follows from the foregoing that such possible change in the zoning regulations must not be remote or speculative.' Nichols on Eminent Domain, 3rd ed., Vol. 4, sect. 12.322, pages 238-243."

341 F.2d at 946-47 (footnote omitted) (emphasis added) (quoting with approval from state's brief). In *Wolf* the court reversed the district court's finding on the valuation of a plot of condemned land on the ground that certain items of evidence relating to a possible zoning change and its effect on the property's value had been held inadmissible. Among these items was evidence showing "that prior to the condemnation the [land] had been contracted to be sold at a high price, conditioned upon obtaining a new classification." 341 F.2d at 947. *See also Reservation Eleven Associates* v. *District of Columbia,* 420 F.2d 153 (D.C. Cir. 1969); *United States* v. *1,291.83 Acres of Land,* 411 F.2d 1081 (6th Cir.

1969); *United States* v. *Benning*, 330 F.2d 527 (9th Cir. 1964).

These cases make clear that the possibility of a zoning change and the probable value of property after the zoning change must be "considered" when appraising the value of the property prior to the change. Critically, however, "the property must not be evaluated as though the rezoning were already an accomplished fact. It must be evaluated under the restrictions of the existing zoning [with] consideration given to the impact upon market value of the likelihood of a change in zoning." 4 *Nichols on Eminent Domain* ¶ 12.322[1], at 12-657 (3d ed. 1977).

The bankruptcy law itself in a general way supports the teaching of the condemnation cases. In the context of conducting a "fair valuation" of property to determine whether a business is insolvent, one must "estimate . . . what can be realized out of the assets *within a reasonable time* either through collection or sale at the regular market value." 1 *Collier on Bankruptcy* ¶ 1.19[4], at 123-24 (14th ed. 1968) (emphasis added). *See also id.* at 128-30 (valuation of real estate).

We conclude that these principles should also apply to the valuation of property for the purpose of determining whether a debtor's estate has an equity in property that is to be sold free of encumbrances in a Chapter X proceeding. In such a case, it is unrealistic either to ignore entirely the possibility of a zoning change or to assume that the change will occur. Here, although the contract price should not have been equated with the fair market value, the difference between the two was probably slight in view of the reasonable likelihood of a zoning change. Thus, the property may reasonably be evaluated at a figure closer to the contract price than to the fair market value absent subdivision plan approval.

A finding that the estate has an equity in the property would thus plainly not be clearly erroneous. The bank con-

cedes that the sum of the bank's lien and the outstanding taxes is less than $800,000. Following the principles above set forth, the value of the property is somewhere between the sale price of $1,440,000 and the $1,000,000 fair market value of the land without subdivision plan approval as stipulated by the parties. On this basis the estate has a substantial equity in the property. The bank notes that there are outstanding mechanics' liens which with interest may total almost $700,000. The bank, however, has not disputed the trustee's argument that, according to California law, the deed of trust to the property held by Collateral is superior to the mechanics' liens. The trustee also argues that the $880,000 deed of trust held by Collateral is superior to the bank's lien, but even if it is not it still gives the trustee a substantial equity in the property.[2]

A finding that the contract is in the best interests of the estate would also not be clearly erroneous. Any realistic valuation of the property is closer to the sale price than to the fair market value of the land. There is good reason to believe that the sale will be completed: Daly City had already approved a plan with greater density housing than the sale contract contemplated; there are further indications that Daly City will approve the subdivision plan; and Damavandi Corporation is obligated under the contract to

2 At a preliminary hearing there was evidence from which the court could have found that the trustee had been soliciting offers for the property for over a year; at least four offers to purchase had been made, each of which was conditioned upon the offeror's receiving "subdivision approval" from the local planning board; the Daly City Planning Board might look favorably upon the construction of a substantial project on the property, particularly in light of the board's prior approval for a previous owner of a higher density subdivision; the principal amount of the bank's claim was approximately $460,000; and the bank, in a law suit in California, had asserted title to a $250,000 deposit which might serve to offset and reduce *pro tanto* the amount claimed by the bank. Moreover, the mechanics' liens, the priority of which is now being litigated in state courts, appear to be somewhat duplicative or overstated.

accept the property if the plan is approved.[3] A year's delay in realization of money from the property would not unduly burden the appellant bank: the bank is in no danger of losing its interest, and it will suffer no great financial strain from a deferred payment.

The bank finally argues that it should be allowed to foreclose immediately regardless of the interests of the estate or the other creditors. It relies exclusively on *Lincoln-Alliance Bank & Trust Co.* v. *Dye*, 115 F.2d 234 (2d Cir. 1940) (per curiam), which reversed a district court order continuing a stay against a mortgagee's foreclosure on a ship, finding that the trustee could not justify any further delay. *Lincoln-Alliance*, however, arose from a situation quite different from the one underlying the case at hand. The ship involved in *Lincoln-Alliance* was substantially the entire corpus of the estate and its value was roughly equal to the sum owing on the mortgage. There was thus no justification for a fourteen-month delay. The delay in the present case has not been unreasonable given the complexity of the estate, the complications in respect to claims asserted against the property, and the possibility of a viable reorganization plan, as well as the fact that some of the delay may have been of the bank's own making.

We conclude that the authorization of the sale contract by the trial judge was not an abuse of discretion, given the support in the record for the necessary findings that the trustee had an equity in the property and that the sale is equitable for all concerned. Accordingly we affirm.

Judgment affirmed.

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3 The bank's contention that the contract for sale to Damavandi Corp. is an option is incorrect. The contract is a conditional contract. Although the satisfaction of the condition, plan approval by Daly City, is dependent upon Damavandi's acting vigorously to secure that approval, Damavandi is obligated under the contract to make a good faith effort to secure it. In doing so it obviously will spend, and perhaps has already spent, considerable sums in preparing the application to Daly City. Because Damavandi must seek plan approval and must purchase the land if it obtains approval, it lacks the contractual freedom characteristic of an option.